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Supreme Court of the United States

OCTOBER TERM, 1942

No. 456

AIR REDUCTION COMPANY, INCORPORATED,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT OF PETITION

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OCTOBER TERM, 1942

No.

AIR REDUCTION COMPANY, INCORPORATED,
Petitioner,
against
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

For Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

Petitioner, Air Reduction Company, Incorporated, a New York corporation, prays that a writ of certiorari issue to review a decision of the United States Circuit Court of Appeals for the Second Circuit in the above cause, handed down on July 16, 1942, and the decree entered therein on August 1, 1942, ordering and decreeing that the decision of the United States Board of Tax Appeals herein in favor of the petitioner be reversed and the cause remanded.

Statement.

The matter here involved is the liability of the petitioner to Federal income tax under the Revenue Act of 1934, the relevant provisions of which are set forth in Appendix A (*infra*, pp. 14-15). Two questions are presented, arising from the transactions involving petitioner's

capital stock summarized in the following paragraphs numbered I and II.

I. Prior to the close of the year 1935, the petitioner owned 109,952 of the 132,299 shares of stock of Pure Carbonic Company, a corporation engaged in an allied activity and operated as a subsidiary of the petitioner (R. 17). The remaining 22,347 shares were owned by U. S. Industrial Alcohol Company (R. 17); and prior to the close of the year 1935 the petitioner acquired those shares, in exchange for 5,258 shares of the petitioner's own stock, thus giving petitioner 100% ownership (R. 16-17). Of the shares previously owned by petitioner, 87,275 shares had previously been acquired in exchange for petitioner's stock (R. 17), so that a total of 109,622 shares, or over 82% of the stock of the subsidiary, was acquired solely in exchange for petitioner's own stock, the remaining shares having been purchased from time to time for cash (R. 17). The value of the 22,347 shares acquired from U. S. Industrial Alcohol Company was $888,602 (R. 16); and the cost to petitioner of the 5,258 shares of its own treasury stock issued in exchange therefor, computed under the "first-in, first-out" method, was $182,536.73 (R. 16). Respondent claimed that the difference between those two amounts, $706,065.27, constituted taxable income to the petitioner (R. 16-17).

II. In 1933, the petitioner had given various of its officers options to purchase shares of its stock, for the purpose of giving them an incentive stock interest, at $57.65 a share, which was the average cost of the treasury stock which the petitioner then held (R. 17). During the year 1935, the petitioner sold 3,200 shares of its treasury stock to such officers, pursuant to such options, for a total of $184,480 (R. 17). Computed under the "first-in, first-out" method, the cost to petitioner of the shares so sold was

$120,973.81 (R. 17); and the respondent claimed that the difference between those amounts, $63,506.19, was taxable income to the petitioner.

Prior to May 2, 1934, the Treasury regulations, commencing with those issued under the Revenue Act of 1918, had uniformly provided that a corporation realized no gain or loss from the purchase or sale of its own stock. By T. D. 4430, approved May 2, 1934, the existing provision to that effect contained in Article 66 of Regulations 77 was amended; and the amendment was continued in Article 22(a)-16 of Regulations 86, issued under the Revenue Act of 1934. Copies of the original and the amended regulation are hereto appended, marked "Appendix B" and "Appendix C," respectively (*infra*, pp. 17 and 18).

The retroactive effect of the amendment was considered by this Court in *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110, in which it was held that the amendment could not be applied retroactively to transactions occurring during the year 1929. Following a dictum in the Court's opinion in that case, the United States Board of Tax Appeals held in the present case that the amended regulation was not effective during the year 1935 (R. 18-19). The Board further held that in any event neither of the transactions in question came within the scope of the amended regulation and that the petitioner had not realized any taxable income from either of them (R. 19-20).

The order of the Board of Tax Appeals was reversed and the cause remanded by the Circuit Court of Appeals for the Second Circuit, Judge Learned Hand dissenting (Decree, R. 44; Opinions, R. 35-43). It is submitted that the Court erred in reversing the order and in holding that any taxable income had been realized by the petitioner from either of the transactions in question, and that the order and decision of the Board should have been affirmed.

Jurisdiction.

Under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925, and under Section 8(a) of the said Act, it is competent for this Court to grant the petition herein and to review the said decision and decree of the Circuit Court of Appeals, which decree was entered on August 1, 1942, as above stated. This petition is presented on October 14, 1942.

Questions Presented.

The questions presented are:

1. Did the petitioner realize taxable income in thus acquiring, in exchange for shares of its treasury stock, the last outstanding minority shares of stock of a subsidiary corporation, the total shares of its subsidiary's stock acquired solely in exchange for petitioner's voting stock being over 80%?

2. Did the petitioner realize taxable income in thus selling to certain of its officers under options previously given to them, pursuant to an incentive stock interest plan, shares of its treasury stock at the average cost to petitioner of the treasury stock held at the time the options were given?

Reasons for Allowance of Writ.

Both questions present important questions of federal law which have not been, but should be, settled by this Court. Moreover, the decision of the Circuit Court of Appeals upon the first question is in conflict with the decision of the Circuit Court of Appeals for the Third Circuit in *Commissioner* v. *Dana*, 103 F. (2d) 359, and misapplies

the decision of this Court in *Helvering* v. *Southwest Consolidated Corp.*, 315 U. S. 194.

WHEREFORE, it is respectfully submitted that the petition should be granted.

Washington, D. C.

October 14, 1942.

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